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# *Individual Accounts in Other Countries*

*by Barbara E. Kritzer*

The United States is currently engaged in a national discussion about whether to make personal accounts a part of Social Security. To date, 31 other countries have implemented some type of individual, or personal, account as part of their mandatory retirement income systems. This article identifies those countries, categorizes how the individual accounts fit into their retirement income systems, and identifies some basic characteristics of the accounts. The article also mentions a number of other countries that have either passed legislation that has not yet been implemented or are considering adopting individual accounts.

For this discussion, the term *individual account* will be used to describe plans in other countries that include some type of personal retirement account. Because this analysis of individual accounts is intended to inform the current U.S. debate involving Social Security, the discussion is limited to countries in which such accounts are part or all of a mandatory retirement income program.

## *What Is an Individual Account?*

The International Social Security Association classifies an individual account as "an arrangement in which capital belonging to an individual person accumulated from mandatory or voluntary contributions is recorded so that it may be withdrawn in the case of certain specified future contingencies" (ISSA and INPRS 2003).

Many countries have voluntary retirement income plans in addition to the mandatory system. The United States has many examples of such plans. Individual retirement accounts allow workers to contribute a certain amount per year to an individual account with the financial institution of their choice. Employees and sometimes employers contribute to 401(k) plans, which provide a range of investment choices offered by the employer. Defined contribution plans can be considered individual accounts, as can some hybrid plans, since they combine the features of defined benefit and defined contribution plans. However, these plans are not part of the formal Social Security system.

Individual accounts may form the basis of a country's retirement system or may serve as a complement to the basic public program. In some countries, workers are required to contribute to an individual account. In others, workers may choose whether to have an individual account, but they may not opt out of the larger system of which the individual account is a part.

### *Types of Individual Accounts*

Individual accounts may be divided into three categories:

- individual,
- occupational, and
- notional.

"In the popular pension discussion," as Holzmann and Palacios (2001, 2) report, "'individual accounts' are often used as short hand for funded, privately managed defined-contribution type pension arrangements." In this approach, which was pioneered in Chile, each worker (and sometimes the employer) is required to contribute a certain percentage of earnings to an individual account with a public or private asset manager. At retirement, the benefit is based on the insured's contributions plus returns on investments minus administrative fees. This type of account may be called an *individual retirement program*. In some countries, like the United Kingdom, they are called *personal pensions*.

Variations on this approach—with some form of public pay-as-you-go program and individual accounts as another component—are called mixed systems. Participation is mandatory and may include a choice between an individual account and an earnings-related program. A

**Table 1.**
**Countries with individual accounts as part of mandatory systems for retirement income**

| Country | Date implemented | First pillar | Second pillar |
|---|---|---|---|
| Argentina | 1994 | Earnings-related and means-tested | Choice |
| Australia | 1992 | Means-tested | Occupational |
| Bolivia | 1997 | Individual retirement | . . . |
| Bulgaria | 2000 | Earnings-related and means-tested | Individual retirement |
| Chile | 1981 | Individual retirement | . . . |
| China | 1997 | Flat-rate [a] | Occupational [a] |
| Colombia | 1993 | Choice | . . . |
| Costa Rica | 2000 | Earnings-related and means-tested | Individual retirement |
| Croatia | 2001 | Earnings-related | Individual retirement |
| Denmark | 2002 | Flat-rate | Individual retirement [b] |
| Dominican Republic | 2003 | Individual retirement | . . . |
| El Salvador | 1998 | Individual retirement | . . . |
| Estonia | 2002 | Flat-rate and earnings-related | Individual retirement |
| Hong Kong | 2000 | Flat-rate and means-tested | Occupational |
| Hungary | 1998 | Earnings-related | Individual retirement |
| Italy | 1995 | Notional and means-tested | . . . |

(Continued)

DEFINITIONS:

Types of non–individual account programs

"Earnings-related pensions" provide a pension based on earnings and are financed by contributions from employers and employees.

"Flat-rate pensions" provide a uniform benefit based on years of service or residence but are independent of earnings and are financed by either payroll contributions (employee, employer, or both) or general revenues.

"Means-tested pensions" are paid to eligible persons whose own or family income, assets, or both fall below designated levels. They are generally financed through government contributions, with no contributions from employers or employees.

"Provident funds" place all employee and employer contributions in a single, publicly managed fund for later repayment to the employee when defined contingencies occur.

Types of individual account programs

"Individual retirement programs" are those in which employees and, in some cases, employers contribute a certain percentage of earnings to an individual account managed by a public or private fund manager chosen by the employee. The accumulated capital in the individual account is used to purchase an annuity, make programmed withdrawals, or do both and may be paid as a lump sum.

"Notional accounts," or "notional defined contributions," are a variant of a traditional earnings-related pay-as-you-go pension in which a hypothetical account is created for each insured person, with the account containing all contributions during his or her working life. A pension is calculated by dividing that amount by the average life expectancy at the time of retirement and indexing it to various economic factors.

"Occupational pensions" are financed by employer and, in some cases, employee contributions. Employers, union trustees, or both choose an investment manager for an entire company or occupation. Benefits are paid as a lump sum, annuity, or pension.

"Choice" indicates that the worker may choose between individual retirement and earnings-related pay-as-you-go programs.

few Latin American countries have adopted the Chilean approach, and many Latin American and Central and Eastern European countries have set up mixed systems.

Some countries maintain individual accounts as part of mandatory *occupational pension plans* that are set up by either an employer or group of employers and are sometimes connected to labor groups such as trade unions. The employer (and sometimes the employee) is required to contribute a percentage of payroll (Yermo 2002). Mandatory occupational plans are mainly found in Western Europe.

A third type of individual account is the *notional defined contribution*, or *notional*, *account*. In this type of program, a hypothetical account is created for each insured person, which contains all contributions made during the employee's working life and is indexed to a particular measure such as wage growth. The pension is calculated by dividing the amount credited to that account by the insured's average life expectancy at the time of retirement, effectively providing an annuity. Unlike individual and occupational accounts, in which benefit obligations are funded by assets accumulated during a retiree's working years, notional accounts are generally financed on a pay-as-you-go basis. The Swedes created the concept of the notional account, and other countries such as Poland and Latvia have adopted their model.

**Table 1.**
**Continued**

| Country | Date implemented | First pillar | Second pillar |
|---|---|---|---|
| Kazakhstan | 1998 | Individual retirement | . . . |
| Kosovo | 2002 | Flat-rate | Individual retirement |
| Kyrgyzstan | 1997 | Notional | . . . |
| Latvia | 1996; 2001 [c] | Notional | Individual retirement |
| Mexico | 1997 | Individual retirement | . . . |
| Mongolia | 2000 | Notional | . . . |
| Nigeria | 2004 [d] | Individual retirement | . . . |
| Peru | 1993 | Choice | . . . |
| Poland | 1999 | Notional | Individual retirement |
| Russia | 2002 | Flat-rate | Notional and individual |
| Singapore | 1997 | Provident fund | Individual retirement [e] |
| Slovakia | 2005 | Notional | Individual retirement |
| Sweden | 1999 | Notional and means-tested | Individual retirement |
| United Kingdom | 1995 | Flat-rate and means-tested | Choice [f] |
| Uruguay | 1996 | Earnings-related and means-tested | Choice [g] |

SOURCES: Holzmann, MacArthur, and Sin 2000; Stott 2000; Bateman, Kingston, and Piggott 2001; Kritzer 2001/2002; Bateman 2002; AIOS 2003; ISSA and INPRS 2003; Stott 2003; Koshutova 2004; SSA 2004; Williamson 2004; SSA 2004–2005; Holzmann and Hinz 2005; SSA 2005.

NOTE: . . . = not applicable. The country has no mandatory individual accounts in the second pillar.

a. No national program as yet; separate systems in some regions only.

b. In addition to the Special Pension (SP), under a separate program that cannot be characterized as either individual retirement or occupational, the Labor Market Supplementary Pension (ATP) contributions are pooled and one single entity manages the investments.

c. Notional account program implemented in 1996; individual retirement program in 2001.

d. In 2004, the program began for public-sector workers only. Private-sector workers are expected to be incorporated into the program in 2005.

e. Central Provident Fund (CPF) members are permitted to invest part of their CPF savings in approved instruments under the Central Provident Investment Scheme (CPFIS).

f. Choice of state earnings-related, occupational, or personal pension.

g. Mandatory for higher incomes; voluntary for lower incomes.

Provident funds—publicly managed savings plans—are not usually considered individual accounts. All employer and employee contributions to the provident fund are pooled into a single fund. Benefits are generally paid as a lump sum with accrued interest, and under certain circumstances employees are permitted partial access to savings before retirement. Provident funds are generally found in developing countries (SSA 2005).

## *First or Second Pillar?*

The term *pillar* has been used since the 1970s to describe the major programs that make up a national retirement income system.[1] Many countries, like the United States, rely on a single mandatory pillar—typically a publicly managed, pay-as-you-go (pay-go) program. The World Bank book (1994) *Averting the Old Age Crisis* called for the creation of multipillar systems: a reformed pay-go first pillar; a second pillar with mandatory, privately managed individual accounts; and a third pillar for voluntary retirement savings.[2] Several countries have adopted the 1994 World Bank model; others have implemented the Chilean model, in which a mandatory, privately managed personal account forms the first pillar of the retirement income system.

Carmelo Mesa-Lago (2001) defines the variations of the Chilean-type individual account prototype as substitutive, mixed, and parallel. *Substitutive* is the pure Chilean model, in which individual accounts replace the pay-go pillar. *Mixed* refers to a reformed pay-go system as the first pillar and individual accounts as the second pillar. *Parallel* indicates that workers have a choice between the pay-go and the individual account programs.

Estelle James (1998) characterizes different types of accounts within a multipillar framework:

- The *Latin American model*, in which individuals select an investment manager for their retirement funds;
- The *OECD model*, in which the employer, the union trustee, or both choose an investment manager for an entire company or occupation;[3] and
- The *Swedish model*, which combines a first-pillar notional account with a second-pillar individual account.

## *Classifying Individual Accounts*

Table 1 (on the previous page) identifies the countries that have individual accounts as part of a mandatory system for retirement income. It categorizes the accounts as individual, occupational, or notional and indicates whether they form part of the first or second pillar of the country's main retirement income system. Many systems have a non–individual account component that provides a flat-rate benefit or benefits either based on earnings or subject to a means test.

Countries that have followed the Chilean or substitutive model—first-pillar mandatory individual accounts—are Bolivia, the Dominican Republic, El Salvador, and Kazakhstan. In Nigeria, the first-pillar mandatory individual accounts program began operation for public-sector workers in 2004; private-sector workers are expected to be incorporated in 2005 (SSA 2004–2005). Choice or parallel systems are found in Argentina, Colombia, Peru, the United Kingdom, and Uruguay.

The World Bank model or mixed system—a reformed pay-go program as the first pillar and mandatory individual accounts as the second pillar—has been popular in Central and Eastern Europe: Bulgaria, Croatia, Estonia, and Hungary. Costa Rica also follows this model. Kosovo's first pillar provides a basic pension, funded by general revenues, for all citizens aged 65 or older (Koshutova 2004).

A variant, the Swedish model—a first-pillar notional defined contribution plan plus second-pillar mandatory individual accounts—was set up in Latvia, Poland, and Slovakia. Some countries, however, have only notional defined contribution programs: Italy, Kyrgyzstan, and Mongolia (Williamson 2004). Russia, on the other hand, has a notional defined contribution component combined with a flat-rate universal benefit and individual accounts (Stott 2003). Mandatory second-pillar occupational systems are found in Australia, Hong Kong, and in some regions in China (Bateman 2002, SSA 2005).

Two countries that do not fit neatly into these categories are Denmark and Singapore. Denmark has two separate second-pillar programs: the Special Pension (SP), an individual retirement program, and the Labor Market Supplementary Pension (ATP), which is not easily characterized as either individual or occupational. Singapore allows its provident fund members to invest a portion of their savings in approved instruments under the Central Provident Fund Investment Scheme (SSA 2004, SSA 2004–2005).

Several other countries are either considering a switch to mandatory individual accounts or have recently passed legislation that has not yet been implemented. Laws have been passed in Ecuador (2001), Macedonia (2000 and 2002), Nicaragua (2000), Romania (2004), Taiwan (2004), Thailand (2004), Ukraine (2003), and Uzbekistan (2004) (ISSA and INPRS 2003, SSA 2004–2005, Holzmann and Hinz 2005). Most of these laws create a two-pillar system. Implementation of the laws in both Ecuador and Nicaragua has been postponed, and revisions to the laws are being considered (SSA 2004–2005).

Countries studying mandatory individual account options include Armenia, Azerbaijan, the Czech Republic, and Honduras (ARKA News Agency 2005, Asociación de AFP 2005, Azer-Press 2005).

Table 2 provides details of selected programs, including funding, type of retirement benefit available, and the existence of a guaranteed minimum benefit. The table includes only countries for which reliable data are available. These programs are funded by the employee,

**Table 2.**
**Characteristics of selected mandatory individual account programs, by country**

| Country | Funding | Guaranteed minimum pension | Type of retirement benefit available | | | Early retirement available |
|---|---|---|---|---|---|---|
| | | | Installment | | Lump sum | |
| | | | Annuity | Other | | |
| Argentina | Employee | Yes | Yes | Yes | No | Yes |
| Australia | Employer | No | Yes | Yes | Yes | No |
| Bolivia | Employee | No | Yes | No | No | Yes |
| Bulgaria | Employee and employer | Yes | Yes | No | Yes | Yes |
| Chile | Employee | Yes | Yes | Yes | No | Yes |
| China [a] | Employee and employer | No | No | Yes | Yes | Yes |
| Colombia | Employee and employer | Yes | Yes | Yes | Yes | Yes |
| Costa Rica | Employer | No | Yes | No | No | Yes |
| Croatia | Employee | Yes | Yes | No | No | Yes |
| Denmark | Employee [b] | Yes | No | Yes | Yes | No |
| Dominican Republic | Employee and employer | Yes | Yes | Yes | No | Yes |
| El Salvador | Employee and employer | Yes | Yes | Yes | No | Yes |
| Estonia | Employee and employer | Yes | Yes | Yes | Yes | No |
| Hong Kong | Employee and employer | No | No | No | Yes | Yes |
| Hungary | Employee | Yes | Yes | No | Yes | No |
| Kazakhstan | Employee | Yes | Yes | No | Yes | Yes |
| Kosovo | Employee and employer | Yes | Yes | No | Yes | -- |
| Latvia | Employee | Yes | Yes | No | No | Yes |
| Mexico | Employee and employer | Yes | Yes | Yes | Yes | Yes |
| Peru | Employee | Yes | Yes | Yes | No | Yes |
| Poland | Employee | Yes | Yes | No | No | No |
| Slovakia | Employee and employer | No | Yes | Yes | Yes | Yes |
| Sweden | Employee and employer | Yes | Yes | No | No | c |
| United Kingdom | Employee and employer | No | Yes | Yes | Yes | Yes |
| Uruguay | Employee | No | Yes | No | No | Yes |

SOURCES: Holzmann, MacArthur, and Sin 2000; Stott 2000; Bateman, Kingston, and Piggott 2001; United Nations 2001; Kritzer 2001/2002; Bateman 2002; AIOS 2003; Koshutova 2004; Lendacky 2004; SSA 2004; Williamson 2004; SSA 2004–2005; Holzmann and Hinz 2005; SSA 2005.

NOTES: A "guaranteed minimum pension" refers only to a specific provision for the individual account pillar and not to other safety net benefits that might be available in other pillars.

-- = no information available.

a. No national program as yet.

b. Both employer and employee contribute to the Labor Market Supplementary Pension (ATP). Only the employee contributes to the Special Pension (SP).

c. Flexible retirement from the age of 61.

the employer, or both. Most countries provide a government-financed guaranteed minimum pension to those who have contributed to the system for a certain period of time and whose account balance would not yield a minimum level. The type of retirement benefit varies: in some countries, only an annuity is available; in others, the insured may select either some type of installment payment or a lump sum.[4] All workers have access to their individual accounts at retirement age regardless of the account balance. Many countries offer early retirement benefits if the account balance is sufficient.

## Notes

[1] A three-pillar system has been legally embedded in Switzerland's constitution since 1972.

[2] The World Bank report *Old-Age Income Support in the Twenty-first Century: An International Perspective on Pension Systems and Reform* (Holzmann and Hinz 2005) updates this model to add "an enhanced focus on basic income provision for all vulnerable elderly" (p. 10), including a safety net financed by general revenues. The report also calls notional accounts "a promising approach to reform or to implement an unfunded first pillar" (p. 13).

[3] The OECD model is not a concept created by the OECD (Organisation for Economic Co-operation and Development); it is a term that describes the programs in many Western European countries that belong to the OECD.

[4] In some countries, such as Chile, workers are permitted to withdraw funds before retirement for other uses, provided they have made a certain number of contributions and their account balance is at a certain level.

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